

to the Commission prior to its implementation for review and approval under § 40.4 of this chapter.

(c) An applicant for designation, or a designated contract market, may request that the Commission consider under the provisions of section 15(b) of the Act any of the contract market's rules or policies, including both operational rules and the terms or conditions of products listed for trading.

[66 FR 42277, Aug. 10, 2001, as amended at 67 FR 62878, Oct. 9, 2002]

§ 38.5 Information relating to contract market compliance.

(a) Upon request by the Commission, a designated contract market shall file with the Commission such information related to its business as a contract market, including information relating to data entry and trade details, in the form and manner and within the time as specified by the Commission in the request.

(b) Upon request by the Commission, a designated contract market shall file with the Commission a written demonstration, containing such supporting data, information and documents, in the form and manner and within such time as the Commission may specify, that the designated contract market is in compliance with one or more designation criteria or core principles as specified in the request, or that is requested by the Commission to enable the Commission to satisfy its obligations under the Act.

(c) *Delegation of authority.* The Commission hereby delegates, until it orders otherwise, the authority set forth in paragraph (b) to the Director of the Division of Market Oversight or such other employee or employees as the Director may designate from time to time. The Director may submit to the Commission for its consideration any matter that has been delegated in this paragraph. Nothing in this paragraph prohibits the Commission, at its election, from exercising the authority delegated in this paragraph.

(d) Upon a change of ownership of an existing designated contract market, the new owner shall file with the Secretary of the Commission at its Washington, DC, headquarters, a certification that the designated contract

market meets all of the requirements of sections 5(b) and 5(d) of the Act and the provisions of this part 38.

[66 FR 42277, Aug. 10, 2001, as amended at 67 FR 62878, Oct. 9, 2002; 71 FR 1964, Jan. 12, 2006]

§ 38.6 Enforceability.

An agreement, contract or transaction entered into on or pursuant to the rules of a designated contract market shall not be void, voidable, subject to rescission or otherwise invalidated or rendered unenforceable as a result of:

(a) A violation by the designated contract market of the provisions of section 5 of the Act or this part 38; or

(b) Any Commission proceeding to alter or supplement a rule, term or condition under section 8a(7) of the Act, to declare an emergency under section 8a(9) of the Act, or any other proceeding the effect of which is to alter, supplement, or require a designated contract market to adopt a specific term or condition, trading rule or procedure, or to take or refrain from taking a specific action.

APPENDIX A TO PART 38—GUIDANCE ON COMPLIANCE WITH DESIGNATION CRITERIA

This appendix provides guidance on meeting the criteria for designation under Sections 5(b) and 6 of the Act and this part, both initially and on an ongoing basis. The guidance following each designation criterion is illustrative only of the types of matters an applicant may address, as applicable, and is not intended to be used as a mandatory checklist. Addressing the issues and questions set forth in this appendix would help the Commission in its consideration of whether the application has met the criteria for designation. To the extent that compliance with, or satisfaction of, a criterion for designation is not self-explanatory from the face of the contract market's rules (as defined in § 40.1 of this chapter), the application should include an explanation or other form of documentation demonstrating that the applicant meets the designation criteria of Section 5(b) of the Act.

Designation Criterion 1 of section 5(b) of the Act: *IN GENERAL—To be designated as a contract market, the board of trade shall demonstrate to the Commission that the board of trade meets the criteria specified in this appendix.*

A board of trade preparing to submit to the Commission an application for designation

as a contract market is encouraged to contact Commission staff for guidance and assistance in preparing an application. Applicants may submit a draft application for review and feedback prior to the submission of an actual application without triggering the application review procedures of §38.3.

Designation Criterion 2 of section 5(b) of the Act: *PREVENTION OF MARKET MANIPULATION*—*The board of trade shall have the capacity to prevent market manipulation through market surveillance, compliance, and enforcement practices and procedures, including methods for conducting real-time monitoring of trading and comprehensive and accurate trade reconstructions.*

A designation application should demonstrate a capacity to prevent market manipulation, including that the contract market has trading and participation rules deterring abuses and a dedicated regulatory department, or an effective delegation of that function.

Designation Criterion 3 of section 5(b) of the Act: *FAIR AND EQUITABLE TRADING*—*The board of trade shall establish and enforce trading rules to ensure fair and equitable trading through the facilities of the contract market, and the capacity to detect, investigate, and discipline any person that violates the rules. The rules may authorize—(A) transfer trades or office trades; (B) an exchange of—(i) futures in connection with a cash commodity transaction; (ii) futures for cash commodities; or (iii) futures for swaps; or (C) a futures commission merchant, acting as principal or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of the contract market or a derivatives clearing organization.*

(a) Establishing and enforcing trading rules to ensure fair and equitable trading on a contract market, among other things, includes providing to market participants, on a fair, equitable and timely basis, information regarding, prices, bids and offers, as applicable to the market.

(b) Such trading rules should be designed with adequate specificity.

(c) A contract market that authorizes transfer trades or office trades; an exchange of futures for physicals or futures for swaps; or any other non-competitive transactions, including block trades, should have rules particularly authorizing such transactions and establishing appropriate recordkeeping requirements.

Designation Criterion 4 of section 5(b) of the Act: *TRADE EXECUTION FACILITY*—*The board of trade shall—(A) establish and enforce rules defining, or specifications detailing, the manner of operation of the trade execution facility maintained by the board of trade, including rules or specifications describing the operation of any electronic matching platform;*

and (B) demonstrate that the trade execution facility operates in accordance with the rules or specifications.

(a) An application of a board of trade to be designated as a contract market should include the system's trade-matching algorithm and order entry procedures. An application involving a trade-matching algorithm that is based on order priority factors other than price and time should include a brief explanation of the algorithm.

(b) A designated contract market's specifications on initial and periodic objective testing and review of proper system functioning, adequate capacity and security for any automated systems should be included in its application. A board of trade should submit in the contract market application, information on the objective testing and review carried out on its automated system. The Commission believes that the guidelines issued by the International Organization of Securities Commissions (IOSCO) in 1990 (which have been referred to as the "Principles for Screen-Based Trading Systems"), and adopted by the Commission on November 21, 1990 (55 FR 48670), as supplemented in October, 2000, are appropriate guidelines for an electronic trading facility to apply to electronic trading systems. Any program of objective testing and review of the system should be performed by a qualified independent professional (but not necessarily a third-party contractor).

Designation Criterion 5 of section 5(b) of the Act: *FINANCIAL INTEGRITY OF TRANSACTIONS*—*The board of trade shall establish and enforce rules and procedures for ensuring the financial integrity of transactions entered into by or through the facilities of the contract market, including the clearance and settlement of the transactions with a derivatives clearing organization.*

(a) A designated contract market should provide for the financial integrity of transactions by setting appropriate minimum financial standards for members and non-intermediated market participants, margining systems, appropriate margin forms and appropriate default rules and procedures. Absent Commission action pursuant to its exemptive authority under section 4(c) of the Act, transactions executed on the contract market (other than stock futures products), if cleared, must be cleared through a derivatives clearing organization registered as such with the Commission. The Commission believes ensuring and enforcing the financial integrity of transactions and intermediaries, and the protection of customer funds should include monitoring compliance with the contract market's minimum financial standards. In order to monitor for minimum financial requirements, a contract market should routinely receive and promptly review financial and related information.

(b) A designated contract market should have rules concerning the protection of customer funds that address appropriate minimum financial standards for intermediaries, the segregation of customer and proprietary funds, the custody of customer funds, the investment standards for customer funds, related recordkeeping procedures and related intermediary default procedures.

Designation Criterion 6 of section 5(b) of the Act: *DISCIPLINARY PROCEDURES*—*The board of trade shall establish and enforce disciplinary procedures that authorize the board of trade to discipline, suspend, or expel members or market participants that violate the rules of the board of trade, or similar methods for performing the same functions, including delegation of the functions to third parties.*

The disciplinary procedures established by a designated contract market should give the contract market both the authority and ability to discipline and limit or suspend a member's activities as well as the authority and ability to terminate a member's activities pursuant to clear and fair standards. The authority to discipline or limit or suspend the activities of a member or of a market participant could be established in a contract market's rules, user agreements or other means. An organized exchange or a trading facility could satisfy this criterion for a member with trading privileges but having no, or only nominal, equity, in the facility and for a non-member market participant by expelling or denying future access to such persons upon a finding that such a person has violated the board of trade's rules.

Designation Criterion 7 of section 5(b) of the Act: *PUBLIC ACCESS*—*The board of trade shall provide the public with access to the rules, regulations, and contract specifications of the board of trade.*

A designated contract market should provide information to the public by placing the information on its Web site.

Designation Criterion 8 of section 5(b) of the Act: *ABILITY TO OBTAIN INFORMATION*—*The board of trade shall establish and enforce rules that will allow the board of trade to obtain any necessary information to perform any of the functions described in this appendix, including the capacity to carry out such international information-sharing agreements as the Commission may require.*

A designated contract market should have the authority to collect information and documents on both a routine and non-routine basis including the examination of books and records kept by the contract market's members and by non-intermediated market participants. Appropriate information-sharing agreements could be established with other boards of trade or the Commission could act

in conjunction with the contract market to carry out such information sharing.

[66 FR 42277, Aug. 10, 2001, as amended at 71 FR 1965, Jan. 12, 2006]

APPENDIX B TO PART 38—GUIDANCE ON, AND ACCEPTABLE PRACTICES IN, COMPLIANCE WITH CORE PRINCIPLES

1. This appendix provides guidance on complying with the core principles, both initially and on an ongoing basis, to maintain designation under Section 5(d) of the Act and this part. The guidance is provided in paragraph (a) following each core principle and it can be used to demonstrate to the Commission core principle compliance, under §§38.3(a) and 38.5. The guidance for each core principle is illustrative only of the types of matters a board of trade may address, as applicable, and is not intended to be used as a mandatory checklist. Addressing the issues and questions set forth in this appendix would help the Commission in its consideration of whether the board of trade is in compliance with the core principles. To the extent that compliance with, or satisfaction of, a core principle is not self-explanatory from the face of the board of trade's rules (as defined in §40.1 of this chapter), an application pursuant to §38.3, or a submission pursuant to §38.5 should include an explanation or other form of documentation demonstrating that the board of trade complies with the core principles.

2. Acceptable practices meeting selected requirements of the core principles are set forth in paragraph (b) following each core principle. Boards of trade that follow the specific practices outlined under paragraph (b) for any core principle in this appendix will meet the selected requirements of the applicable core principle. Paragraph (b) is for illustrative purposes only, and does not state the exclusive means for satisfying a core principle.

Core Principle 1 of section 5(d) of the Act: *IN GENERAL*—*To maintain the designation of a board of trade as a contract market, the board of trade shall comply with the core principles specified in this subsection. The board of trade shall have reasonable discretion in establishing the manner in which it complies with the core principles.*

A board of trade applying for designation as a contract market must satisfactorily demonstrate its capacity to operate in compliance with the core principles under section 5(d) of the Act and §38.3. The Commission may require that a board of trade operating as a contract market demonstrate to the Commission that it is in compliance with one or more core principles.

Core Principle 2 of section 5(d) of the Act: *COMPLIANCE WITH RULES*—*The board of trade shall monitor and enforce compliance with*